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Russian Federation

Agricultural Situation

Agriculture as a "National Priority Project"

2005

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Report Highlights:

President Putin has ordered a significant increase in spending on Russia's domestic agriculture. The major thrusts of this initiative are revitalization of the livestock sector and expansion of rural credit, particularly for smallholders.

Includes PSD Changes: No
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Summary

On September 5, 2005 Russian President Vladimir Putin designated agriculture one of four priorities for national development, and toward the end of November the Russian parliament appropriated funds for implementing programs under this initiative. Over the past few weeks more information has become available regarding the specific projects to be carried out. The agriculture project is currently referred to as "Agroindustrial Complex Development". It features three major thrusts and is broken into specific program areas. The thrusts are:

- accelerated livestock sector development with financing set at 7.45 billion rubles in 2006 and 7.18 billion rubles in 2007;
- stimulation of smallholders with financing set at 6.6 billion rubles in 2006 and 9.37 billion in 2007; and
- provision of rural housing for young specialists working in rural areas and particularly for those engaged in production agriculture.

The first two of these program areas are to be implemented by the Ministry of Agriculture (www.mcx.ru) and as they relate to production agriculture and trade in agricultural products are the focus of this report.

Objectives

The specific goals of the project, set for 2008, are:

- increase milk production by 4.5 percent and meat by 7 percent;
- increase marketing of products from private plots and private farms (smallholders) by 5 to 7 percent;
- finance the sale through "leasing" (seller financing) 100,000 head of elite brood livestock;
- acquire high-capacity equipment and machinery for servicing the equivalent of 130,000 head of cattle; and
- further develop the existing 2,550 agricultural consumer cooperatives and create more.

Livestock Sector Development

Accelerated livestock development is to be accomplished in part through expansion of access to credit, coupled with reduction of import tariffs on machinery and equipment used in the meat and dairy sectors. Funding for livestock sector development is broken down as follows:

- 3.45 billion rubles in 2006 and 3.18 billion rubles in 2007 for interest rate buydown subsidies on commercial investment credits with up to eight-year terms for construction and modernization of livestock complexes, which is expected to attract about 40 billion rubles of commercial financing;
- 4.0 billion rubles in 2006 and another 4.0 billion rubles in 2007 for renovation of fixed capital in the livestock sector, including acquisition of new equipment and brood livestock through "leasing" (what in the West is known as seller financing). These funds will be

channeled through the state-owned Russian Agricultural Leasing Company (Rosagroleasing, www.rosagroleasing.ru);

- amendment of the tax code as well as other laws as appropriate to make investment in livestock production more attractive;
- amendments to customs import tariffs and technical regulations with the intent of making import of foreign equipment (e.g., milking parlor equipment) easier, and to set tariff rate quotas on imports of meat into Russia (see GAIN Report RS-5084); and
- public-private partnerships via the Investment Fund to attract more private investment to construction of meat and dairy processing plants in areas with surplus production.

In remarks to the foreign agricultural attaches in Moscow December 15, Minister of Agriculture Aleksey Gordeyev stated that the intent of this project, as well as the rest of the national priorities (education, housing and health care), is to improve standards of living. The livestock initiative is specifically intended to reverse the 15-year decline in livestock numbers, particularly of cattle, and toward that end 50,000 head of elite bovine brood stock is to be imported from the European Union in 2006. In addition, an unspecified quantity of boars for improving swine genetics is to be acquired from abroad in 2006.

Smallholder Development

Smallholder development is to be promoted through:

- founding of input supply and marketing cooperatives in rural villages to serve private plot producers;
- expansion of capacity to process products from private plots and private farms (smallholders);
- expansion of rural credit cooperatives with the assistance of the state-owned Russian Agricultural Bank (Rosselkhozbank, www.rshb.ru);
- creation of a land mortgage system to support rural credit, with a goal of financing 5,000 farms of an average size of 100 hectares.;
- interest rate buydown subsidies for credit extended to private plot owners, private farmers (smallholders), and consumer cooperatives these producers found, using federal funds to support an interest rate of 95% of the Bank of Russia refinance rate, and using provincial government funds to support the remaining 5% of the Bank of Russia refinance rate. Loan limits through government support mechanisms are set at 300,000 rubles for private plot producers, 3 million rubles for private farmers, and agricultural consumer cooperatives at 10 million rubles. In 2006 2.9 billion rubles of appropriated funds will be used for this purpose, and in 2007 that will be increased to 3.67 billion rubles.

In addition, the charter capital of Rosselkhozbank will be raised by 3.7 billion rubles in 2006 and another 5.7 billion rubles in 2007 with the intent of creating and expanding rural consumer cooperatives.

Rural Housing

Improving rural housing for young specialists and agricultural producers will be implemented through a Federal Targeted Program, "Rural Social Development". Since this is a

development project related to personnel policy, the Ministry of Regional Development (www.minregion.ru) will implement it jointly with the Ministry of Agriculture. Funding for this activity is accordingly not included in the Ministry of Agriculture's budget. This project is intended to halt the rural flight of qualified personnel from rural areas, which is creating a shortage of competent technical workers and managers in agriculture, by improving housing conditions for workers with higher and vocational educations.

Funding

The total volume of money to be made available for projects administered by the Ministry of Agriculture is currently set at 30.9 billion rubles, of which 14.2 billion is to be spent in 2006 and 16.7 billion in 2007.

Table: Ministry of Agriculture of Russia, Budget Earmarks for "Agroindustrial Development" Program, 2006-2007, in billion rubles

Activity	2006	2007	TOTAL
"Accelerated Livestock Sector Development"			
Subsidized interest rate buydowns for investment credits of up to 8 years for construction and modernization of livestock complexes	3.45	3.18	6.63
Augmentation of charter capital of the Russian Agricultural Leasing Company	4.0	4.0	8.0
Total	7.45	7.18	14.63
"Stimulating Smallholder Development in the Agroindustrial Complex"			
Subsidies for interest rate buydowns on credit and loans for development of agricultural production on private household plots and peasant (farmer) operations and agricultural consumer cooperatives they found	2.9	3.67	6.57
Augmentation of charter capital of the Russian Agricultural Bank	3.7	5.7	9.4
Total	6.6	9.37	15.97
Overhead and project oversight	0.15	0.15	0.3
GRAND TOTAL	14.2	16.7	30.9

Source: Ministry of Agriculture of the Russian Federation,
http://www.mcx.ru/dep_doc.html?he_id=797&doc_id=7107

Current exchange rate: RUR 28.5 = \$1.00

Analysis

One positive aspect of this program is the effort to direct the funds through quasi-market mechanisms. In lieu of the more familiar grants and bad loan writeoffs, these funds are being used to make more commercial credit available to agricultural producers. Furthermore, efforts are not focused exclusively on large-scale producers: for the first time,

federal credit resources are being made available to smallholders, who produce over half of Russia's domestically produced food.

Another positive note is the Russian government's recognition, finally, of the need for stimulation of cooperative development, especially of credit cooperatives. Russia's current rural credit cooperatives exist primarily thanks to efforts by U.S. and German donors and training programs. The lack of marketing infrastructure for small-scale producers could potentially be addressed by marketing cooperatives.

A third positive development is overt acknowledgement that Russian agriculture can benefit from an infusion of foreign equipment and genetics, and expressions of intent to import foreign-built machinery and brood livestock. If implemented properly, this could raise the efficiency and profitability of affected parts of Russia's livestock sector, and thus both raise profitability and increase demand for other inputs (e.g., frozen embryos, semen, improved feed.)

Major questions remain, however. One is how great an impact can be expected from this relatively limited amount of money (slightly over a billion dollars over two years, to be spread out across 16 million private plot producers and somewhat more than 200,000 "peasant" farmers plus their attendant cooperatives). If spent wisely, the funding could leverage much additional private investment, as the interest rate buydowns are intended to do.

However, the appropriateness of investment in largescale livestock operations harkens back to the gigantism of the Soviet era, and specifically to Communist Party leader Leonid Brezhnev's ill-fated effort to build about 500 beef growout complexes in the 1970s. While demand for the end product of beef and pork producers unquestionably exists, there remains a lack of both management competency and comprehension of the need for proper nutrition when dealing with highly productive western broodstock. Related to this is the wisdom of importing within a tightly compressed period, two years, several tens of thousands of head of elite livestock for creation of livestock complexes yet to be constructed or staffed.

Over half of Russian livestock output comes from smallholders, a fact the Russian government can no longer ignore. It has also become clear over the past two years that agricultural holding companies and large operators, which under political pressure have taken over a significant number of bankrupt former collective and state farms, have restored their new production units to profitability in part by abandoning perennially unprofitable livestock operations. This tendency of large operators to shed marginal and unprofitable livestock subsidiaries is behind the interest rate buydowns and promises of reduced import tariffs on machinery needed in the livestock sector.

If Russia is to restore its livestock sector, the single most labor-intensive sector of agriculture, it can only do so given the current state of technology by encouraging smallholders, and this is tacitly acknowledged in the provision of funding for smallholders, including for the first time for private subsidiary plot producers. Over half of meat and milk is currently produced by private plot holders and small farmers, yet many (perhaps half) of the private plot holders are of retirement age and thus due to go out of production over the next decade. If meat and dairy production is not to shrink dramatically, it is therefore imperative that this subsector be transformed within the next few years and that profitable, small- to medium-sized production units for livestock be encouraged to emerge. The policy intent of this project is rather clear: retirement over time of the most undersized of the small, private plots, and transformation of the larger, more commercially oriented of them into *bona fide* (and most likely, officially registered for tax and statistical purposes) farmers.

Paradoxically, however, a similar amount of money is being appropriated to rebuild large-scale livestock operations of the type that lost money and went bankrupt over the 1990s. This infusion of cash does not so far appear to be accompanied by efforts to improve training in herd management, animal nutrition, and business administration. If this portion of the priority project ends up consisting solely of an attempt to apply a technical (genetic) solution to what is essentially an economic and managerial problem, it will fail as well.

Significant growth in the livestock sector would have two additional consequences: pressure on the marketing chain, which is currently oriented toward imports of large quantities of meats as feedstock for the food processing industry; and increased domestic consumption of Russia's current, exportable grain surplus. In the first instance, no marketing channels currently exist for delivery of significantly larger quantities of meat from either smallholders or new, as-yet unbuilt livestock complexes to the market, and this will be a serious constraint. In the latter case, Russia's grain surplus appeared in the 1990s only due to the collapse of the Soviet-era livestock industry. The livestock sector's resurgence would cut into that surplus.

A second question is whether Russia's growing problems with corruption will result in diversion of a significant portion of this funding to nonproductive activities, allocation of funds based on non-economic criteria, or obstruction of projects pending payment of bribes. Local (*rayon* and provincial) governments are already issuing instructions to the local offices of Rosagroleasing and Rosselkhozbank as to the projects to be funded. "Shadow tenders" are already being held in advance of official tenders to ensure that contracts are directed in "profitable" directions, according to trade contacts. The influential "Krestyanskiye vedomosti" newspaper noted in an op-ed November 11, "...our agrarian legislation is not so much a densely woven statutory fabric as a widely spaced fishnet through which not merely a pike but a whole shark could freely pass."

A third question is whether such a large infusion of cash into the currently very small cooperative credit system (as of January 1, 2005 only 707 credit cooperatives in all of Russia, with assets of 1.3 billion rubles) will not swamp it. The project is intended to add 1,000 credit cooperatives to the system, i.e., more than to double it, but loan officers and credit managers are not created overnight. Little thought appears to have been given ahead of time to how this system would be staffed and how the staff would be trained. Another pressing issue is the lack of integrated and well thought-out cooperative legislation. Russian cooperatives operate under the authority of contradictory statutes, particularly with regard to tax obligations, and so are completely at the mercy of potentially corrupt local authorities. Until that issue is addressed rapid expansion of credit cooperatives, as well as other types of rural cooperatives, will be problematic.